89-2027
No. ___

In The

Supreme Court of the United States

October Term, 1989

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY,

Petitioner,

vs.

LAURO F. CAVAZOS, in his official capacity as Secretary, United States Department of Education, and UNITED STATES DEPARTMENT OF EDUCATION,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether *Bowen v. Agencies Opposed to Soc. Sec. Entrap.*, 477 U.S. 41 (1986) permitted Congress to amend the written, statutorily authorized contracts between the South Carolina State Education Assistance Authority (S.C. Authority) and the Secretary of the United States Department of Education (Secretary) so as to halt approximately $2.7 million in reimbursement payments to the S.C. Authority for its guarantees on student loans that were made prior to the amendments?

2. Whether the decisions of this Court permit the Secretary to take $2.7 million from the S.C. Authority's Reserve Fund when the S.C. Authority has title to the fund under South Carolina law, and when the fund is used for the purposes for which it was created under South Carolina law?

PARTIES IN THE COURT OF APPEALS

The parties are listed in the caption; however, for the convenience of the Court, the Petitioner South Carolina State Education Assistance Authority will be referenced herein as S.C. Authority. The Respondents are United States Department of Education and the Secretary thereof which shall be collectively referenced herein as the Secretary.

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The Petitioner respectfully requests that a Writ of Certiorari issue to review the judgment and opinion of the panel of the United States Court of Appeals for the Fourth Circuit, entered on March 7, 1990.

OPINIONS BELOW

On May 31, 1989, the Honorable Karen LeCraft Henderson, Judge, United States District Court for the District of South Carolina, granted the S.C. Authority's Motion for Summary Judgment herein and correctly found that the Secretary had unconstitutionally taken the S.C. Authority's property rights in its contracts with the Secretary for reimbursements for its guarantees on student loans and that the 1987 Amendments to 20 U.S.C. § 1072 (December 1987 Amendments) which authorized that taking are unconstitutional as a violation of the Fifth Amendment of the United States Constitution. *South Carolina State Education Assistance Authority v. Cavazos, et al.*, 716 F.Supp. 886 (DCSC, 1989) App., Ex. D, *infra*, p. 19a. The Secretary appealed the District Court's decision to the United States Court of Appeals for the Fourth Circuit. On March 7, 1990, the panel of the Court of Appeals reversed the decision of the District Court. 897 F.2d 1272 (4th Cir. 1990). App. Ex. A, p. 1a. The S.C. Authority petitioned the Court of Appeals for rehearing and suggested rehearing in banc, but the court denied the petition by Order of March 28, 1990.

JURISDICTION

This Court has jurisdiction to review the final decision of the Court of Appeals entered March 7, 1990, under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The following statutes are involved in this case:

1. 20 U.S.C. § 1072(e) as added by PL 100-203, § 3001 (December 1987 Amendments) (App. Ex. G, p. 42a);

2. 20 U.S.C. § 1078(c)(1)(A) as written prior to the December 1987 Amendments: "The guaranty agency shall be deemed to have a contractual right against the U.S., during the life of such loan, to receive reimbursement according to the provisions of this subsection. . . . " (App. Ex. F, p. 41);

3. United States Constitution, Fifth Amendment: "No person . . . shall be . . . deprived of life, liberty or property without due process of law, nor shall private property be taken for public use without just compensation.";

4. United States Constitution, Fourteenth Amendment, § 4. The validity of the public debt of the United States authorized by law, including debts incurred for payments of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. . . . ";

5. Sections 59-115-50 through 59-115-70, 59-115-100 and 59-115-110 of the *Code of Laws of South Carolina*, 1976, as amended. (App. Exs. H-L, pp. 47-54).

STATEMENT OF THE CASE

A.

FACTS

The Honorable Karen LeCraft Henderson, in her decision in the District Court of South Carolina, upheld the precedent of the United States Supreme Court in concluding that the December 1987 Congressional Amendments to 42 U.S.C. § 1072(e) (App. Ex. G, p. 42,) had taken the Authority's property interest in its contracts with the Secretary in violation of the Fifth Amendment of the United States Constitution (App. Ex. D, p. 19a). Subsequently, in a decision that clearly conflicts with the opinions of the United States Supreme Court, the Court of Appeals for the Fourth Circuit reversed Judge Henderson and failed to recognize the South Carolina Education Assistance Authority's (S.C. Authority) property interest in its contracts and in its reserve fund. (App. Ex. A, p. 1a) The Court of Appeals has ruled in a way, as stated by Judge Henderson, that would cause "[f]aith in contracts with the government [to] be seriously shaken. . . . " (App. Ex. D, p. 35a)

The S.C. Authority is the agency established by South Carolina state law to guarantee student loans made in the State of South Carolina and to perform other functions under State law concerning the making, insuring and guaranteeing of student loans. Section 59-115-50, of the *Code of Laws of South Carolina* (1976), as amended.[1] (App.

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[1] Legislation for the S.C. Authority codified in Title 59, Chapter 115 of the *Code of Laws of South Carolina*, 1976, was enacted by Act 433, *Acts and Joint Resolutions of South Carolina*, 1971, and amended by Act 474 of 1978.

Ex. H, p. 47a, *infra*) Pursuant to written contracts, entered in 1978 (in Record below) and authorized by state and federal law (§ 59-115-100, App. Ex. K, p. 53a; 20 U.S.C. § 1078(c)(1)(A), App. Ex. F, p. 41a) the Secretary and the United States Department of Education provide "reinsurance" (reimbursements) and reimbursement payments for administrative costs to the S.C. Authority in exchange for the S.C. Authority's guaranteeing student loans under the federal guaranteed student loan Program (GSL) in South Carolina. *See also* section 1078(f)(1)(B) as written prior to the December 1987 Amendments. These reimbursements from the Secretary go into the S.C. Authority's reserve fund along with other money which is used as described below.

The S.C. Authority guarantees student loans made by the South Carolina Student Loan Corporation (Corporation) by using money in its reserve fund, including the contractual reimbursements from the Secretary, to reimburse the Corporation for defaults on these loans. (Related Exhibits in Record below) The Corporation then uses this money from the S.C. Authority, along with collections on student loans not in default, to pay the bondholders for bonds issued to fund the student loan program. *Id.* The Secretary's contractual obligation to pay reimbursements on defaulted loans is a key to ensuring the S.C. Authority's ability to meet its commitment to guarantee student loans which, in turn, ensures the payment of bondholders.

Under South Carolina law, the S.C. Authority has title to the money in its reserve fund and that fund is to be used only for purposes authorized by State law. Pursuant to 1971 legislation (Note 2, *supra*), " . . . *all money*

received pursuant to the authority of the [South Carolina State Education Assistance Act], whether it is proceeds from the sale of bonds . . . or as payments of student loans . . . or as insurance premiums . . . or any other receipts or revenues derived hereunder shall be deemed as *trust funds to be held and applied solely as provided in the [South Carolina State Education Assistance Act].*" (emphasis added) Section 59-115-110 of the *Code* App. Ex. L, p. 54a. When the S.C. Authority extinguishes its liability to remedy defaults on student loans, state law further provides that monies in the State's reserve fund shall be deposited in the State's Sinking Fund for revenue bonds for the State student loan program upon the extinguishment of the liability. Section 59-115-70 of the *Code*. App. Ex. J, p. 51a. Monies in the S.C. Authority's loan fund, which includes administrative allowances paid by the Secretary, are used only for purposes authorized by State law. Section 59-115-60 (App. Ex. I, p. 49a).

Although the S.C. Authority had title to its reserve funds under State law and Congress had expressly recognized that the S.C. Authority had a "contractual right" to the payment of reimbursements and administrative allowances from the Secretary (§§ 1078(c)(1)(A), App. Ex. F, p. 41a and 1078(f)(1)(B)), Congress made changes in the applicable legislation in 1987 that unconstitutionally took the S.C. Authority's property interest in those matters. 20 U.S.C. § 1072(e) as added by PL100-203 (December 1987 Amendments), App. Ex. G, p. 42a. These changes in the law were made then for the purposes of reducing the federal deficit rather than for the enhancement of the GSL Program. Specifically, Congress required that certain guaranteed student loan agencies, including the S.C.

Authority, reduce the size of their reserve funds by a total of $250 million. App. Ex. G, p. 42a. This legislation established a formula for the calculation of reserve funds of these agencies deemed to be "excess", and the Secretary determined thereunder that the S.C. Authority had approximately $2.7 million in excess reserves.

The S.C. Authority challenged the determination of the Secretary under the provisions for requesting a waiver under section 1072(e), but the Secretary denied the request for a waiver. The Secretary chose a method of recovery of the "excess reserves" which was the withholding and cancelling of claims for reimbursements. Section 1072(e)(2)(B). He has continued to withhold reimbursements from the S.C. Authority since then. The Secretary's withholding of $2.7 million in reimbursements for default claims applies entirely retroactively to defaults on loans made prior to the December 1987 Amendments for which the Secretary and Congress had already contractually committed to pay reinsurance claims.

Congress never reserved to itself or to the Secretary the right to make changes in these contracts that would apply retroactively to loans that had been guaranteed by the S.C. Authority in reliance upon the S.C. Authority's receipt of reimbursements under these contracts. This deprivation of the S.C. Authority's interest in its contracts and its reserve fund clearly conflicts with the decisions of the United States Supreme Court.

B.

THE PROCEEDINGS BELOW AND THE ISSUES FOR REVIEW

Following the denial of its request for a waiver, *supra*, the S.C. Authority brought this action against the

Secretary before the District Court of the District of South Carolina and moved for Summary Judgment.[2] In granting the S.C. Authority's Motion for Summary Judgment, Judge Henderson, found that the S.C. Authority had a property interest in its contracts for reimbursements for defaulted loans and that the 1987 Amendments to § 1072(e) unconstitutionally took the S.C. Authority's property without just compensation in violation of the Fifth Amendment to the United States Constitution. (App. Ex. D, p. 38a). With respect to the language of the contracts and in the regulation referring to changes in the law,[3] she concluded that Congress had not reserved the right to curtail the payments which it had contracted to pay and no such authority could be given by regulation. Moreover, she concluded that even if Congress had reserved the authority to make these changes, ". . . Congress could not by amending the legislation take away [the Authority's] property." (App. Ex. D, p. 37a) She noted as follows the result that would occur if Congress had the authority to amend, without limitation, United States Government contracts:

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[2] The District Court was alleged to have jurisdiction of this action under 20 U.S.C. 1082(a)(2) (suits concerning the GSL Program), 28 U.S.C. §§ 2201 and 2202 (interpretation of the provisions of the United States Constitution and the statutes of the United States) and 5 U.S.C. § 701, *et seq.* (Judicial Review of the decision of the Secretary)].

[3] One of the contracts in question stated that the S.C. Authority "shall be bound by all changes in the act or regulations in accordance with their effective dates" and another contract stated that the S.C. Authority would comply with the federal statute and regulations thereunder, (*see also* 34 C.F.R. § 682.400(d)).

> If, as the defendants contend, a party to a contract with the federal government under these circumstances does not possess a property right in its contract with the government, then, contrary to *The Sinking Fund Cases* [99 U.S. (9 Otto) 700, 25 L.Ed. 496 (1879)], the power of Congress to alter its obligations under a contract containing a reservation of power to amend would be effectively unlimited because no party to that contract could ever acquire a property right to the benefits due under the contract. *Faith in contracts with the government would be seriously shaken by such a ruling. . . . Id.* at p. 35a (emphasis added)

Judge Henderson stated the conclusion of the court as follows:

> Accordingly, the court concludes that here, as in [*Lynch v. United States*, 292 U.S. 571, 78 L.Ed. 1434, 54 S.Ct. 840 (1934)], the Authority has vested property rights in its contracts with the United States to receive reimbursement for payments made to guarantee defaulted loans and to receive advances in administrative cost allowances. As in *Lynch*, the Authority is a party to the contract and has paid valuable consideration for its right to receive reinsurance payments, administrative costs, reimbursements and advances – . . . Furthermore, Congress expressly provided in the 1986 Amendments that the Authority has a 'contractual right' to receive reinsurance payments and administrative cost allowances. This court . . . finds that the Authority's rights constitute property. Because they do constitute property, then, even if a reservation of power to amend the contracts were contained in the legislation authorizing them, Congress could not by amending the legislation take away that property. *Sinking Fund Cases*, 99 U.S. at 720. . . . *Id.* at 37a.

Because of her finding concerning the contracts for reimbursement, Judge Henderson did not reach other issues in this case, including whether the Secretary's action violated the Due Process Clause of the Fifth Amendment, the questioning of the Public Debt Clause of the Fourteenth Amendment and whether he had miscalculated the S.C. Authority's "excess reserves" and erroneously failed to grant a waiver to the S.C. Authority. *Id.* By summary order dated July 5, 1989, she denied the Motion to Alter made by the Secretary. (Ex. E, *infra*, p. 40a).

The Secretary then appealed Judge Henderson's decision to the Court of Appeals for the Fourth Circuit. His appeal of the decision in favor of the S.C. Authority was consolidated with his appeal of the similar case *Maryland Higher Education Loan Corp. v. U.S. Department of Education* (DC Md.), No. 89-270, June 12, 1989, Frederic N. Smalkin, Judge) in which the Maryland District Court adopted the Order of Judge Henderson. The appeal was also consolidated with that of the State of North Carolina from *State of North Carolina v. United States*, 725 F.Supp. 874 (EDNC 1989).

The March 7, 1990 decision of the Panel of the Court of Appeals in these consolidated cases erroneously concluded that regulations for the GSL program prevented any of the guaranty agencies from acquiring an ownership interest in their reserve funds which would entitle the funds to protection as private property under the Taking Clause. (App. Ex. A, p. 1a). Further, the court

made the wrong conclusion that the " . . . public nature of the reserve funds themselves, coupled with the express contractual reservation of the power to amend the terms of the GSL Program and the fact that the legislative changes involve a comprehensive federal/state social welfare program forecloses a finding that the state agencies have obtained unalterable vested property rights to [reimbursement] payments." (App. Ex. A, at p. 12a). This decision of the Court of Appeals errs in concluding that reserve funds are public and improperly grafts unrelated federal program considerations onto a matter controlled by contract. Moreover, in contrast to the well-reasoned decision of Judge Henderson, the Fourth Circuit's decision directly conflicts with opinions of the United States Supreme Court which hold that vested property rights, such as those of the S.C. Authority here, cannot be taken by subsequent amendment.[4]

REASONS FOR GRANTING THE WRIT

The S.C. Authority submits that a Writ of Certiorari should be issued here because the Court of Appeals has made serious errors that conflict with the precedent of

[4] The S.C. Authority petitioned for rehearing and suggested rehearing in banc, but the court denied the Petition. App. Ex. B, p. 14a. The mandate has issued to the District Court. The S.C. Authority did not move for a stay of the mandate (Rule 41, Federal Rules of Appellate Procedure) because the Court of Appeals had previously granted the Secretary a stay on appeal over the objections of the S.C. Authority. Order, August 15, 1989.

this Court and that fail to recognize the vested, enforceable property interest of the S.C. Authority in its reserve fund and in its contracts with the Secretary. These holdings place in doubt many contracts of the federal government as to other matters as well as affect the millions of dollars at issue in the numerous other lawsuits pending concerning this matter in other states. If this ruling stands, Judge Henderson's concern about "faith in government contracts" will become a realty.

I.

THE QUESTIONS PRESENTED ARE OF SIGNIFICANT IMPORTANCE BECAUSE THE ACTIONS OF THE SECRETARY AND CONGRESS CONSTITUTE AN UNCONSTITUTIONAL TAKING OF PRIVATE PROPERTY AND AN UNCONSTITUTIONAL REPUDIATION OF THE DEBT OF THE UNITED STATES.

As set forth below, the S.C. Authority clearly had an enforceable property interest in its written contracts with the Secretary and in its reserve fund which have been unconstitutionally taken here by the actions of the Secretary and Congress. That action of the Secretary and Congress also constitutes an unconstitutional repudiation of the debt of the United States under Amendment Fourteen § 4 of the United States Constitution.

A.

THE SECRETARY HAS BREACHED ITS CONTRACTS WITH THE S.C. AUTHORITY FOR THE PAYMENT OF REIMBURSEMENTS TO THE S.C. AUTHORITY FOR THE S.C. AUTHORITY'S LOSSES ON STUDENT LOANS THAT IT GUARANTEES.

1.

The matter in controversy is controlled by written enforceable contracts between the S.C. Authority and the Secretary, which have been breached by the Secretary.

The Fourth Circuit has clearly misinterpreted and misapplied United States Supreme Court precedent in treating this matter as one of economic regulation or "social welfare" regulation when it is instead controlled by written enforceable contracts between the Secretary and the S.C. Authority. The contracts for reimbursements in the instant case are clearly binding. As enacted prior to the December 1987 Amendments that breached the contracts, the legislation for the guaranteed student loan program provided for " . . . a contractual right of [guaranty agencies such as the S.C. Authority] against the United States *for the life of such loan[s] to receive reimbursements* . . . " (emphasis added) 20 U.S.C. § 1078(c). The binding quality of the written agreements entered in 1978 is emphasized by the language therein as follows which the Fourth Circuit failed to cite or discuss:

> "9. The Commissioner's *obligation* to make [reimbursement] payments as provided for in this agreement shall extend only with respect to loans insured by the agency *prior to* the expiration of the authority provided in the act. . . . ;

> 10. . . . . termination shall not affect obligations incurred under this agreement by either party before the effective date of termination. . . . " (Agreements in Record below)

One of the two written contracts states that the S.C. Authority "shall be bound by all changes in the Act or regulations in accordance with their effective dates" and similar regulatory provisions had been adopted (34 CFR § 682.400(d), but this provision does not permit amendment of the agreement so as to affect vested rights to reimbursements for loans guaranteed prior to the amendments. The Supplemental Agreement, under which the Secretary agrees to reimburse the S.C. Authority for one hundred percent (100%) of its losses on loans, merely states that the S.C. Authority will comply with the federal statute and regulations thereunder neither of which, in 1978 when the contracts were signed, contained provisions for drawing down reserves and withholding reimbursements. *Id.* Moreover, as noted above both agreements provide that *termination " . . . shall not affect obligations incurred under this agreement by either party before the effective date* of termination." (emphasis added). The above "termination" and "obligation" provisions clearly manifest an intent that subsequent changes in applicable federal law would not affect obligations already incurred such as reimbursements for loans already guaranteed, which is consistent with the binding nature of federal contracts, and with the congressional recognition that these contract rights existed for the "life of such loan(s)", 20 U.S.C. Section 1078(c)(1)(A). (App. Ex. F, p. 41a)

2.

Congress and the Secretary lack the authority to amend the contracts and to withhold reimbursements for loans already made in which the S.C. Authority had vested rights.

The Fourth Circuit has failed to give effect to the decisions of this Court which recognize that the contracts of the United States are binding. As stated in *Lynch v. United States, supra,* 292 U.S. at 579 and 580, 54 S.Ct. at 843 and 844, a case cited but not discussed by the Fourth Circuit:

> "[W]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals. . . . If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term applied as it would be if the repudiator had been a state, or a municipality or a citizen." 292 U.S. at 580; 54 S.Ct. at 844.

The Fourth Circuit failed to apply *Lynch* and other decisions of this Court when it concluded as follows that the guaranteed student loan agencies involved did not have enforceable property interests in these contracts:

> " . . . the public nature of the reserve funds themselves, coupled with the express contractual reservation of the power to amend the terms of the GSL Program and the fact that the legislative changes involve a comprehensive federal/state social welfare program, forecloses a finding that the state agencies have obtained unalterable vested property rights to certain payments." App. Exhibit A, p. 12a.

According to South Carolina's Supreme Court, the S.C. Authority's reserve funds here are not public (*Durham v. McLeod*, 256 S.C. 409, 192 S.E.2d 202, 204 (1972))[5] and no case supports the conclusion that a state cannot have a vested property interest in money related to that program even if a "comprehensive federal/state social welfare program" is involved. Moreover, the contractual reservation of the power to amend terms of the program does not extend to abrogating vested contract rights retroactively here.

Judge Henderson relied upon Lynch to conclude that Congress had not reserved the power to amend the contract and that " . . . the notice provisions in the contract and in the regulations cannot grant such power." App. Ex. D, p. 19a. Accord, *Education Assistance Corp. v. Cavazos*, 902 F.2d 622 (8th Cir., 1990). She properly distinguished the instant case from that of *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 91 L.Ed.2d 35, 106 S.Ct. 2390 (1986) in that Congress had expressly reserved the right to make changes as to the

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[5] The Fourth Circuit also indicates that because the money for the reimbursements goes into the reserve fund of the S.C. Authority, the S.C. Authority has no property interest in the reimbursements because of what the court improperly states is "complete federal control over the use of the fund." As discussed *infra*, the S.C. Authority has title to and a property interest in its reserve fund. Moreover, even if the S.C. Authority did not have a property interest in its reserve fund, it does have a vested property interest in its contractual right to reimbursements as found by Judge Henderson, a right that is not affected by what the S.C. Authority does with the reimbursements after the Secretary meets his contractual obligation to pay them.

Social Security matter in question in *Bowen* whereas Congress did not make such a reservation as to the instant matter. Although *Bowen* stated that the reserved power to legislate with respect to contracts and other matters remains intact unless surrendered in unmistakable terms, that authority to legislate as to the contracts in question concerning reimbursements for pre-existing loans has been surrendered by Congress here because of the statutory provisions giving the S.C. Authority and other guaranty agencies a contractual right to reimbursement for the life of the loans. 20 U.S.C. 1078(c)(l)(A). Moreover, even if this surrendering language were not set out in the statute, Congress and the Secretary could not use legislative powers to deprive the S.C. Authority and other guaranty agencies of their property rights that had already vested by contract and statute prior to the legislation.

Even assuming that Congress could change these contracts prospectively as to future matters, what is at issue here is Congress' unconstitutionally changing these contracts retroactively as to rights that had already vested for reimbursements for pre-existing loan guarantees. *Bowen* recognizes that binding quality of contracts of the United States as follows:

> " . . . Congress [cannot rely upon a reserved power to amend] to take away property already acquired under the operation of the charter, or deprive the corporation of fruits already reduced to possession of contracts lawfully made." 477 U.S. at 55, 106 S.Ct. at 2398, citing *Sinking Fund Cases, supra.*

The Sinking Fund Cases quoted in *Bowen* also held that "[Congress] cannot undo what has already been done, and it cannot unmake contracts that have already been

made. . . . " and that " . . . sheer oppression and wrong cannot be inflicted under the guise of amendment or alteration." 99 U.S. at 721, 25 L.Ed. at 502. *See also Looker v. Maynard*, 179 U.S. 46, 45 L.Ed. 79, 21 S.Ct. 21 (1900); *Miller v. State*, 82 U.S. (15 Wall.) 478, 21 L.Ed. 98, 104 (1873); and *Pennsylvania College Cases*, 80 U.S. (13 Wall.) 190, 20 L.Ed. 550 (1871). Here, because the right of the S.C. Authority to receive reimbursements had vested as to loans made prior to the December 1987 amendments, the contractual commitment of the Secretary must be honored as to these reimbursements.

Accordingly, Judge Henderson properly found that " . . . even if a reservation of power to amend the contracts were contained in the legislation authorizing them, Congress could not by amending the legislation take away that property." The *Sinking Fund Cases*, 99 U.S. at 720. She found that the S.C. Authority had vested rights in its contracts for the following reasons:

> As in *Lynch*, the Authority is a party to the contract and has paid valuable consideration for its right to receive reinsurance payments, administrative cost reimbursements and advances – it has agreed to guarantee the loans and it has administered the GSLP on the State level acting as a middleman between the federal government and the lending institutions. Furthermore, Congress expressly provided in the 1986 Amendments that the Authority has a 'contractual right' to receive reinsurance payments and administrative cost allowances. App. Ex. D at p. 37a.

The Fourth Circuit errs in concluding that the S.C. Authority cannot have a vested right to receive

reimbursement, in part, because a "social welfare program" is involved, but neither *Bowen* nor any other U. S. Supreme Court case makes this holding. If the contracts between the S.C. Authority and the Secretary as written and as directed by statute are not "contracts" as the statute and agreements say that they are, and if those contracts are not enforceable here, then no contracts could be made between State agencies and the Federal Government, a result which would be contrary to the holdings of this court concerning the enforceability of the contracts to the United States.

A primary difference between *Bowen* and the instant matter, which the Fourth Circuit failed to note, is that *Bowen* held that the Social Security matter in question therein " . . . constitute[d] neither a debt of the United States . . . nor an obligation of the United States to provide benefits under a contract . . . " 106 S.Ct. at 2399. The *Bowen* provision " . . . simply was part of a regulatory program over which Congress retained authority to amend. . . . " *Id.* Instead, in the instant matter, a contract controls the relationship of the parties, not merely economic regulations.

The key to the distinction here between the economic regulation in *Bowen* and the contractual obligations in the instant case can be found in *Lynch, supra,* in which the Supreme Court stated as follows:

> "Congress was free to reduce gratuities deemed excessive but Congress was without power to reduce expenditures by abrogating contractual obligations of the United States. *To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an*

> *act of repudiation.*" (emphasis added) 292 U.S. at 580, 54 S.Ct. at 844.

Here, Congress and the Secretary have attempted to " . . . reduce expenditures by abrogating contractual obligations of the United States." *Id.* Such action does not constitute the "practice of economy", as in *Lynch* or a change in "a regulatory program" as in *Bowen*. Instead, the actions of Congress and the Secretary constitute "an act of repudiation" of contract provisions for reimbursements in which the S.C. Authority had a vested interest. *Lynch, supra*. Clearly, under this authority, Congress cannot breach its contracts as it has done here under the guise of economic regulation.

Here, as found by Judge Henderson in the South Carolina District Court, the S.C. Authority has vested rights in its contracts to receive reimbursements, and those rights cannot be taken by the Secretary by language in one of the contracts concerning changes in the law, or by Congress, through legislation. In taking the S.C. Authority's interests in these contracts, the Secretary has violated the Taking Clause of the Fifth Amendment which protects property owned by state and local governments. *United States v. 50 Acres of Land*, 469 U.S. 24, 31, 83 L.Ed.2d 376, 383, 105 S.Ct. 451, 455-456 (1984).

B.

THE S.C. AUTHORITY HAS AN ENFORCEABLE PROPERTY INTEREST IN ITS RESERVE FUND, AND THE SECRETARY IS UNCONSTITUTIONALLY TAKING THAT FUND.

The S.C. Authority's reserve fund consists of monies which are the property of the S.C. Authority.[6] Although South Carolina law designates monies of the S.C. Authority to be trust funds, the S.C. Authority has legal title to those monies, as trustee, and the funds are " . . . to be held and applied solely as provided in [the South Carolina State Education Assistance Act, Section 59-115-10, *et seq.* of the *Code of Laws of South Carolina* (1976)]." Section 59-115-110 of the *S.C. Code* (App. Ex. L, p. 54a); *Chemical Bank v. Steamship Westhampton*, 358 F.2d 574 (4th Cir. 1965); *Neel v. Clark*, 193 S.C. 412, 8 S.E.2d 740 (1940); *Durham v. McLeod, supra*, 192 S.E.2d 202. As stated in *Chemical Bank, supra*, the " . . . Supreme Court has held that beneficiaries of a trust have an interest in the property to which the trustee holds legal title." (emphasis added) 358 F.2d at 584. Here, the S.C. Authority, as trustee, has legal title to the reserve fund as determined by applicable South Carolina legislation.

That the S.C. Authority has title to its reserve fund is emphasized also by section 59-115-70 (App. Ex. J, p. 51a) which states that the reserve fund is to be paid over to the S.C. Authority's reserve fund for bondholders if the S.C.

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[6] Judge Henderson did not reach the reserve fund issue below because of her conclusion discussed above that the S.C. Authority had an enforceable property interest in its contracts for reimbursements which have been breached here.

Authority's liability on its guarantees on student loans has been extinguished. In addition, section 59-115-60 (App. Ex. I, p. 49a) provides that the loan fund of the S.C. Authority is to be used only for the purposes authorized by State legislation. The fund contains the administrative allowances and other moneys being sought by the Secretary under Congress' definition of reserve fund. Moreover, the powers of the S.C. Authority are defined by State law and include guaranteeing student loans under terms and conditions prescribed by the S.C. Authority. Section 59-115-50. (App. Ex. H, p. 47a).

These provisions of South Carolina law are the "existing rules or understandings that stem from an independent source such as State law" which, according to the United States Supreme Court, define the property interests protected by the Constitution. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001, 81 L.Ed.2d 815, 831, 104 S.Ct. 2862 (1984). The Court of Appeals ignored those provisions and instead erroneously concluded that federal regulations related to the reserve fund's usage prevented any of the guaranty agencies from acquiring an ownership interest in the reserve funds which would entitle the funds to protection as private property under the Taking Clause. That conclusion of the Court of Appeals conflicts with the United States Supreme Court and other decisions which clearly show that restrictions on the use of property do not prevent a party from having a property interest in it.

In *Commissioner of Internal Revenue v. Lincoln Savings & Loan*, 403 U.S. 345, 355, 29 L.Ed.2d 519, 91 S.Ct. 1893, 1899 (1971), the United States Supreme Court stated that Lincoln had a "distinct and recognized property interest

in the secondary reserve" fund deposited with the Federal Savings & Loan Insurance Corporation (FSLIC). The Court made this finding despite the fact that the reserve was deposited with another entity, FSLIC, and despite the fact that the fund could be used to cover the losses of FSLIC. Instead, here, the S.C. Authority may use the reserve fund for guaranteeing student loans and paying the cost of the administration of the S.C. Authority's Loan Guaranty Program, the very purposes for which the S.C. Authority was created under state law. 34 C.F.R. § 682.410(a)(2)(i) and (3); § 59-115-50(c) of the *Code of Laws of South Carolina* (1976) (App. Ex. H, p. 47a).

The Court of Appeals decision also conflicts with case law in the zoning context which makes clear that zoning restrictions on the use of property do not constitute a taking unless legitimate State interests are not advanced or economically viable use of the property is denied. *Agins v. City of Tiburon*, 447 U.S. 255, 65 L.Ed.2d 106, 100 S.Ct. 2138 (1980); *Euclid v. Ambler Co.*, 272 U.S. 365, 71 L.Ed. 303, 47 S.Ct. 114 (1926). Therefore, that federal regulations exist as to the reserve fund does not deprive or prevent the S.C. Authority from having a property interest therein because the S.C. Authority still has use of the fund for purposes authorized under State law.

Similarly, in citing *Buchanan v. Warley*, 245 U.S. 60, 62 L.Ed. 149, 38 S.Ct. 16, 18 (1917), as to the "free use, enjoyment and disposal of a person's acquisitions", the Court of Appeals decision overlooked the next paragraph of *Buchanan* which states as follows:

> " . . . dominion over property springing from ownership is not absolute and unqualified. The

> disposition and use of property may be controlled in the exercise of the police power in the interest of the public health, convenience or welfare."

Consequently, that federal regulations apply to some uses of the S.C. Authority's reserve fund does not prevent the S.C. Authority from maintaining a property interest in such fund.

Moreover, in concluding that the federal regulations "completely control the reserve funds' uses", the Court of Appeals decision ignores that the permitted uses of the fund include guaranteeing student loans and paying the cost of the administration of the S.C. Authority's loan guaranty program, the very purposes for which the S.C. Authority was created under South Carolina State law. 34 C.F.R. § 682.410(a)(2)(i) and (3); § 59-115-50(c) of the *Code of Laws of South Carolina, supra*. (App. Ex. H, p. 47a) In addition, the Court of Appeals decision failed to recognize that the S.C. Authority relies upon its reserve fund in its relationships with bondholders, secondary markets and potential lenders. (Exhibits in Record below). Finally, the Court of Appeals decision notes the various sources of the reserve fund specified by regulation, but its conclusion that the S.C. Authority has no property interest in that fund ignores that a number of sources of the fund are under no control by federal officials including state appropriations, investments and "gift[s], grant[s] or other sources" and that the S.C. Authority has broad discretion as to the amount of the insurance premium that it charges as a source for the reserve fund. 34 C.F.R. §§ 682.401(6) and 682.410.

As shown above, the United States Government acquires no property interest in the S.C. Authority's reserve fund merely because its regulations permit the S.C. Authority to use that fund for purposes authorized under South Carolina State law. Nowhere, do federal regulations or statutes grant the Secretary a property interest in that fund. If the federal program went out of existence or the S.C. Authority ended its participation therein, the reserve fund would remain in South Carolina for the purpose of South Carolina's program. Sections 59-115-50, 59-115-60 and 59-115-70, (pp. 42a-52a). Under South Carolina law, the S.C. Authority has title to the fund for the purposes of South Carolina's student loan program.

The Secretary has taken the S.C. Authority's property interest in its reserve fund in violation of the Taking Clause of the Fifth Amendment because his withholding of reimbursement money is based upon money in the S.C. Authority's reserve fund that the Secretary erroneously deemed to be "excess" and payable to the Secretary. The reimbursement payments from the Secretary would go into the reserve fund if they were not being withheld to reduce the "excess". *See* § 1072(e)(5)(A).

C.

THE S.C. AUTHORITY HAS BEEN DEPRIVED OF ITS PROPERTY UNDER THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT.

Although *South Carolina v. Katzenbach*, 383 U.S. 301, 15 L.Ed.2d 769, 86 S.Ct. 803 (1966), provides that states generally are not "persons" entitled to the protection of

the Due Process Clause, the S.C. Authority, as noted, holds its reserve fund in trust for the benefit of its program. The South Carolina Supreme Court, in *Durham v. McLeod, supra,* held that " . . . no public money or credit within the meaning of . . . [Art. XI of the South Carolina Constitution] is employed in making or guaranteeing loans." 192 S.E.2d at 904. Therefore, regardless of whether the S.C. Authority, itself, is a person under the Due Process Clause, it is entitled to raise Due Process claims as the trustee of the reserve fund because the fund consists primarily of non-public money. Because that fund has been taken here, the Secretary's action in taking the reserve fund has violated the Due Process Clause.

D.

THE SECRETARY'S BREACH OF ITS CONTRACTS WITH THE S.C. AUTHORITY AND ATTEMPTS TO COLLECT THE S.C. AUTHORITY'S RESERVE FUND CONSTITUTE AN UNCONSTITUTIONAL REPUDIATION OF THE PUBLIC DEBT OF THE UNITED STATES.

In addition to the Fifth Amendment violations by the Secretary, his breach of the Department's contracts with the S.C. Authority and its taking of the S.C. Authority's reserve fund money also constitutes an independent violation of Section 4 of the Fourteenth Amendment which reads as follows: "[t]he validity of a public debt of the United States, authorized by law, . . . shall not be questioned. . . . " *Perry v. United States,* 294 U.S. 330, 79 L.Ed. 912, 55 S.Ct. 432, 434-435 (1935). The Ohio District Court, in *Ohio Student Loan Commission v. Cavazos,* 709 F.Supp. 1411 (SD Ohio, 1988); rev. (6th Cir., Nos. 89-3166/3238, April 2, 1990), correctly found that the implementation by

the Secretary of the December 1987 Amendments, constituted a violation of § 4 of the Fourteenth Amendment and was a " . . . separate and independent ground for invalidating this cash-recovery provision." Because the December 1987 Amendments and the actions of the Secretary apply entirely to reimbursements for loans already made by the S.C. Authority, the public debt of the United States has been unconstitutionally repudiated.

II.

THE QUESTIONS PRESENTED ARE OF SIGNIFICANT IMPORTANCE IN THAT THEY AFFECT NUMEROUS OTHER STATES, MILLIONS OF DOLLARS IN MONEY AND MANY CONTRACT AND PROPERTY INTEREST ISSUES THAT ARE LIKELY TO RECUR BETWEEN THE STATES AND THE FEDERAL GOVERNMENT.

Numerous other guaranteed student loan agencies have brought suit against the Secretary concerning the December 1987 Amendments. As noted above, over $2.7 million is at stake in the S.C. Authority's case and millions of dollars are at issue as to agencies in other states. *See* e.g. *Ohio Student Loan Corp., supra*. Because substantial issues of private property interests of state and non-profit agencies in matters related to the federal government are likely to continue to arise in the future and because those issues are likely to be resolved incorrectly as a result of the erroneous decision of the Fourth Circuit, granting the Writ of Certiorari is necessary here to avoid future litigation, to correct the errors in the instant case and to avoid wrongful action by federal officials as to contract and other property matters in the future.

CONCLUSION

The Honorable Karen LeCraft Henderson of the District Court recognized and properly applied the Supreme Court's declarations as to contracts in finding that the withholding of reimbursements was an unconstitutional taking. Instead, the decision of the United States Court of Appeals for the Fourth Circuit upholds actions of the Secretary and of Congress which unconstitutionally deprived the S.C. Authority of its vested rights to its reserve fund and to its contracts for reimbursements as to loans made prior to the December 1987 Amendments to § 1072(e). Its decision sharply conflicts with decisions of this Court with respect to the binding nature of contracts of the United States and the nature of property interests generally. If the Fourth Circuit's ruling is allowed to stand, it could result in litigation and erroneous decisions concerning the enforceability of other contracts of the United States and other property matters. Therefore, for these reasons, the South Carolina State Education Assistance Authority respectfully requests that certiorari be granted to correct the errors in the Court of Appeals.

Respectfully submitted,

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Columbia, South Carolina
June 21, 1990

APPENDIX

EXHIBIT A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

PUBLISHED

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff-Appellee

versus

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants-Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE HIGHER EDUCATION ASSISTANCE AUTHORITY

Amici Curiae.

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff-Appellee

versus

LAURO F. CAVAZOS, Secretary of Education; U. S. DEPARTMENT OF EDUCATION

Defendants-Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeals from the United States District Court for the District of South Carolina, at Columbia. Karen L. Henderson, District Judge. (CA-88-2710-16-3)

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofit Maryland Corporation

Plaintiff-Appellee

versus

LAURO F. CAVAZOS, Secretary of the United States Department of Education

Defendant-Appellant

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the District of Maryland, at Baltimore. Frederic N. Smalkin, District Judge. (CA-89-270-S)

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiffs-Appellants

versus

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants-Appellees

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the Eastern District of North Carolina, at Raleigh. Terrence W. Boyle, District Judge. (CA-88-961-CIV-5)

Argued: October 3, 1989 Decided: March 7, 1990

Before RUSSELL, WIDENER, and HALL, Circuit Judges.

Affirmed in part, reversed in part, and remanded with instructions by published opinion. Judge Hall wrote the opinion, in which Judge Russell and Judge Widener joined.

Neil H. Koslowe, Special Litigation Counsel (Stuart E. Schiffer, Acting Assistant Attorney General; William Kanter, Deputy Director, Civil Division, DEPARTMENT OF JUSTICE; Edward C. Stringer, General Counsel;

Harold Jenkins, Brian Seigel, Attorneys, DEPARTMENT OF EDUCATION, on brief) for Appellants. Andrew H. Baida, Assistant Attorney General (J. Joseph Curran, Jr., Attorney General; William F. Howard, Mary L. Preis, Assistant Attorneys General), on brief); James Emory Smith, Jr. (Joseph D. Shine, Attorney General's Office; N. Bruce Holland, DEPARTMENT OF SOCIAL SERVICES, on brief); Thomas J. Ziko, Assistant General (Lacy H. Thornburg, Attorney General; Edwin M. Speas, Jr., Special Deputy Attorney General, on brief) for Appellees. (Jean Frohlicher, NCHELP, Inc.; George G. Olsen, Robert E. Jensen, WILLIAMS AND JENSEN, P.C., on brief) for Amicus Curiae NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC. (Mary Sue Terry, Attorney General; R. Claire Guthrie, Deputy Attorney General; Paul J. Forch, Senior Assistant Attorney General and Chief, Education Section; Richard C. Kast, Assistant Attorney General, on brief) for Amicus Curiae VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY.

HALL, Circuit Judge:

These consolidated appeals arise from actions filed by three different state-created agencies against the Secretary of the United States Department of Education ("Secretary") seeking to have certain portions of the 1987 amendments to the Higher Education Act of 1965 ("the Act") declared unconstitutional and to enjoin the Secretary from withholding payments to them in accordance with the amendments. In the South Carolina and Maryland cases, the district courts declared that the statutory provisions in question violated the Fifth Amendment's prohibition against the taking of private property without just compensation. The North Carolina court, however, upheld the statute's constitutionality. Finding that the

amendments do not effect the unconstitutional taking, we reverse the South Carolina and Maryland judgments and remand for further proceedings. We affirm the judgment in the North Carolina case.

I.

A. Statutory Background

The Act established the Guaranteed Student Loan Program ("GSLP") to assist post-secondary school students. Under the GSLP, private lenders make low-interest loans, subsidized by the federal government, to students. The lenders are insured by various state guaranty agencies that 100% of the unpaid principal of qualifying loans will be paid in case of default. Each state wishing to enable students to participate in the program must either establish its own guaranty agency or designate a private, non-profit agency to serve as such. This agency, in turn, must enter into written agreements with the Secretary by which it agrees to operate the program under GSLP guidelines. The Secretary is also authorized to enter into reinsurance agreements with the guaranty agencies by which the Secretary promises to reimburse between 80%-100% (depending on the agency's default rate) of the amounts expended by the guaranty agency in repaying the unpaid principal remaining on defaulted loans.

In addition to the reinsurance payments, the Secretary is authorized to make advances to enable a new agency to commence operation and administrative cost allowances to offset an agency's operating costs. Subject to statutory restrictions, a guaranty agency is also authorized to receive the following types of payments: (1) a

single insurance premium on each loan (not to exceed 3% of the loan) which is paid by the lender and passed on to the student borrower; (2) a set portion of any amounts collected on defaulted loans for which the agency has received a reimbursement from the Secretary; (3) state appropriations; (4) gifts, grants and similar sources; and (5) investment earnings. Each guaranty agency is required to deposit these funds in a "reserve fund." 34 C.F.R. § 682.410(a)(1). The reserve fund may only be used for those GSLP purposes specified by the Secretary, such as paying claims from lenders and administering the program, 34 C.F.R. § 682.410(a)(2-6).

In response to concerns that these reserve funds had grown unnecessarily large, Congress enacted section 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (the "1987 Amendments"). These amendments required the Secretary to determine, using a statutory formula, the maximum allowable cash reserve for each guaranty agency. 20 U.S.C. § 1072(e)(2). The Secretary was also required to direct any state agency with an excess to transfer such amount to the Secretary. 20 U.S.C. § 1072(e)(2)(A)-(D). Any amounts recovered from the excess reserves were to be deposited into a student loan insurance fund which is used by the Secretary to make reimbursement payments under the GSLP. 20 U.S.C. § 1081(a). The Secretary is also authorized to waive repayment of any excess for certain specified reasons. 20 U.S.C. § 1072(e)(3).

B. The instant Dispute

1. The guaranty agency in South Carolina is the South Carolina State Education Assistance Authority

("Authority"). This non-profit agency was created by statute in 1976 to administer the GSLP. Under the excess reserve formula, the Secretary established a cash reserve ceiling of $500,000 and required the Authority to transfer the excess ($2,739,528). The Secretary denied the Authority's request for a waiver of this transfer requirement. When the Authority refused to transfer any of the excess amount, the Secretary began withholding reinsurance payments otherwise payable, and applying these withheld amounts toward the $2.7 million due.

In October 1988, the Authority filed an action against the Secretary challenging the constitutionality of the excess reserve and related enforcement provisions of the 1987 amendments. The Authority also challenged both the Secretary's computation of the excess amount under the statutory formula and his denial of its request for a waiver. On May 31, 1989, the district court declared that the statutory provisions authorizing the withholding of reimbursements violated the Fifth Amendment's Takings Clause because the Authority had acquired "vested property rights" in such payments. Accordingly, the court enjoined any further withholding of reimbursement payments and ordered the Secretary to release any amounts withheld. *S.C. State Educ. Assistance Authority v. Cavazos*, 716 F. Supp. 886 (D.S.C. 1989). The Secretary appeals from this order.

2. The guaranty agency in Maryland is the Maryland Higher Education Loan Corporation ("MHELC"), a non-profit corporation established by statute in 1963. MHELC entered into GSLP agreements with the Secretary in 1965. Under the statutory formula, the Secretary determined that MHELC was required to transfer $10,797,400

of its reserve fund. The Secretary denied MHELC's waiver request, and the guaranty agency subsequently refused to voluntarily transfer the excess amounts of its reserve fund. After the Secretary began to withhold reimbursement payments, MHELC filed suit for declaratory and injunctive relief. Unlike the Authority, however, MHELC did not challenge the Secretary's computation of its excess, not did it challenge the denial of a waiver. The district court adopted the reasoning of the South Carolina court and granted the relief sought by MHELC. *Md. Higher Educ. Loan Corp. v. U.S. Dept. of Educ.*, Civ. No. S 89-270 (D. Md. June 12, 1989). The Secretary's appeal followed.

3. The North Carolina State Education Assistance Authority ("NCSEAA") was created by the state in 1965 to administer a higher education loan program. In 1966, NCSEAA entered into the first of several agreements with the Secretary by which North Carolina agreed to participate in the GSLP. In 1988, the Secretary informed NCSEAA that it had an excess reserve of $15,911,946. Upon partial approval of NCSEAA's request for a waiver, this amount was reduced to $2,632,785. NCSEAA refused to transfer any of its excess to the Secretary and, as in the Maryland and South Carolina situations, the Secretary began to withhold reimbursement payments otherwise payable under the GSLP.

NCSEAA filed an action in district court challenging, *inter alia*, the constitutionality of the 1987 amendments' excess reserve provisions. On July 20, 1989, the district court upheld the constitutionality of the excess reserve amendments on the ground that the funds in question are public, rather than private, property and, as such, were

not within the ambit of the Fifth Amendment's Takings Clause. Accordingly, the Secretary's motion for summary judgment was granted. *State of N.C. v. United States*, 725 F. Supp. 874 (E.D.N.C. 1989). NCSEAA appeals from this ruling.

II.

In each contract with the Secretary, the executory state agency agrees "to be bound by all changes in the Act or regulations in accordance with their effective dates." The regulations include a similar requirement. 34 C.F.R. § 682.400(d). The South Carolina court cites *The Sinking Fund Cases*, 99 U.S. (9 Otto) 700 (1879), and *Bowen v. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41 (1986), for the proposition that only an *express statutory* reservation in an act of the power to amend is effective to permit subsequent legislative alteration of agreements entered into by the federal government in conformity with such act. We do not read these cases so restrictively. In *Bowen*, although the power to amend was reserved in the authorizing legislation under which the agreements at issue were executed, the Court focused on the notice such express reservation provided to the state that the statute could be amended in the future. *Id.* at 53. Moreover, the Court in *Bowen* noted that the power to amend is deemed to have been reserved *unless* it is expressly relinquished. *Id.* at 52. As the Court noted, "contractual arrangements, including those to which a sovereign itself is party, 'remain subject to subsequent legislation' by the sovereign." *Id.* (quoting *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 147 (1982)). Accordingly, we find no merit in the agencies' arguments that this power to amend was not

reserved. *See also Great Lakes Higher Educ. Corp. v. Cavazos*, 711 F. Supp. 485, 494-96 (W.D. Wis. 1989); *State of Del. v. Cavazos*, 723 F. Supp. 234, 241-42 (D. Del. 1989). We turn, then, to the agencies' contentions that they had "vested property rights" which even a properly reserved power to amend could not reach.

III.

The constitutional provision at the core of these disputes is the Takings Clause of the Fifth Amendment: "[N]or shall private property be taken for public use, without just compensation." Simply stated, the state agencies contend that the transfer requirement of 20 U.S.C. § 1072(e)(2) contravenes this constitutional provision because the agencies' reserve funds constitute "private property" accrued pursuant to contracts with the Secretary. We agree with the Secretary and the North Carolina district court, however, that the excess reserve funds are not "private property" within the meaning of the Takings Clause.

The essential aspects of private property are "free use, enjoyment and disposal," *Buchanan v. Warley*, 245 U.S. 60, 74 (1917), and the "right to exclude others," *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984). As explained in *Ruckelshaus*, such property interests " 'are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law' [citations omitted]." *Id.* at 1001. The nature of the loan program militates against a finding that the state agencies possessed such indicia of private ownership. As the North Carolina district court stated,

"[i]f property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, then it loses its character as 'private' property and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment." *State of N. C. v. United States*, 725 F. Supp. at 876-77 (E.D.N.C. 1989). We agree that the regulations which completely control the reserve funds' uses are the sort of "existing rules or understandings" which prevent any of the guaranty agencies from acquiring an ownership interest in its reserve fund which would entitle it to protection as private property under the Takings Clause.

IV.

An alternative argument raised by the state agencies focuses not on the reserve fund itself as the property allegedly being taken but, rather, on the enforcement mechanism of the 1987 amendments which the state agencies claim acts to take their "vested contractual rights" to receive reimbursement payments. The South Carolina district court held that even if the power to amend had been effectively reserved, the contractual right to reimbursement payments had already vested in the Authority with regard to default payments already made. 716 F. Supp. at 794. The court's analysis proceeds from the principle that contractual rights are generally recognized to be property for purposes of the Takings Clause. *See, e.g., Lynch v. United States*, 292 U.S. 571, 579-80 (1934). Citing *The Sinking Fund Cases*, 99 U.S. at 719-21, the South Carolina court recognized that there exist some limits on the federal government's power to

unilaterally amend its contracts and concluded that the 1987 Amendments had exceeded such limits. For a number of reasons, however, we believe that the state agencies' "contractual rights" to reimbursement payments had not "vested" so as to trigger Fifth Amendment protections.

The analysis of the vested/non-vested nature of the right to reimbursements is intertwined with the earlier discussion of the nature of the reserve funds themselves. The reserve funds are generated solely within the framework of a federal social welfare program involving students and prospective students throughout the nation. Just as the complete federal control over the use of the fund compels the conclusion that the targeted funds do not constitute private property for Fifth Amendment purposes, the contractual right to reimbursement payments destined for inclusion in such reserve funds similarly is not the type of property subject to the "takings" prohibition. The reservation of the power to amend the terms of the GSL program prevents the participating state agencies from invoking the Fifth Amendment Takings bar against subsequent Congressional action. *Great Lakes Higher Educ. Corp.*, 711 F. Supp. at 495-96. The Court in *Bowen* emphasized that the sovereign authority to alter its contracts by subsequent legislation should not, if possible, be foreclosed and especially so in the context of a "comprehensive social welfare program." 477 U.S. at 52-53. We conclude that the public nature of the reserve funds themselves, coupled with the express contractual reservation of the power to amend the terms of the GSL program and the fact that the legislative changes involve a comprehensive federal/state social welfare program,

forecloses a finding that the state agencies have obtained unalterable vested property rights to certain payments.

V.

For the foregoing reasons, the judgments in the South Carolina and Maryland cases are reversed and these cases are remanded for further proceedings consistent with this opinion. The judgment in the North Carolina case is affirmed.

Nos. 89-2975/76/78 – *REVERSED AND REMANDED*

No. 89-2982 – *AFFIRMED*

EXHIBIT B

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff-Appellee

v.

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States, Department of Education; U.S. DEPARTMENT OF EDUCATION;

Defendants-Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofit Maryland Corporation

Plaintiff-Appellee

v.

LAURO F. CAVAZOS, Secretary of the United States Department of Education

Defendant-Appellant

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff-Appellee

v.

LAURO F. CAVAZOS, Secretary of Education; U.S. DEPARTMENT OF EDUCATION

Defendants-Appellants

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiffs-Appellants

v.

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants-Appellees

On Petitions for Rehearing with Suggestions for Rehearing In Banc

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The appellees South Carolina State Education Assistance Authority and Maryland Higher Education Loan Corporation and appellants State of North Carolina and North Carolina Education Assistant Authority's petitions for rehearing and suggestions for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestions for rehearing in banc, and

As the panel considered the petitions for rehearing and is of the opinion that they should be denied,

IT IS ORDERED that the petitions for rehearing and suggestions for rehearing in banc are denied.

Entered at the direction of Judge Hall with the concurrence of Judge Russell and Judge Widener.

For the Court,

JOHN M. GREACEN
CLERK

EXHIBIT C

UNITED STATES DISTRICT COURT

FILED JUN 1 1989

DISTRICT OF South Carolina – Columbia Division

South Carolina State Education Assistance Authority,
Plaintiff,

v.

Lauro F. Cavazos, in his official capacity as Secretary, United States Department of Education, and United States Department of Education,
Defendants.

SUMMARY JUDGMENT IN A CIVIL CASE

ENTERED 6-1-89

CASE NUMBER: C/A 3L88-2710-16

[ ] **Jury Verdict**. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

[xx] **Decision by Court.** This action came to hearing before the Court. The plaintiff's motion for summary judgment having been duly heard and granted;

IT IS ORDERED AND ADJUDGED

that summary judgment is hereby entered for the plaintiff, South Carolina State Education Assistance Authority.

June 1, 1989
Date

ANN A. BIRCH, CLERK
Clerk

/s/ Wanda W. Wiltbank
Wanda W. Wiltbank
(By) Deputy Clerk

EXHIBIT D

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA
COLUMBIA DIVISION

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY, Plaintiff, v. LAURO F. CAVAZOS, in his official capacity as Secretary, United States Department of Education, and UNITED STATES DEPARTMENT OF EDUCATION, Defendants.	CIVIL ACTION NO. 3:38-2710-16 ORDER (Filed May 31, 1989)

I.

This matter is before the Court on cross motions for summary judgment pursuant to Fed. R. Civ. P. 56. All parties agree that no issue of material fact exists and that this matter should be resolved as a matter of law. For the reasons set forth below, the Court grants the plaintiff's motion for summary judgment and denies the defendants' motion.

The South Carolina State Education Assistance Authority ("Authority") is a non-profit agency that guarantees student loans under the federal Guaranteed Student Loan Program ("GSLP"). The GSLP is the largest federal program providing financial assistance to students seeking a post-secondary education. Under the

GSLP, various lenders such as commercial banks and savings and loan institutions make low-interest loans to students. The loans are subsidized by the federal government and are further protected by guarantees made by fifty-eight state or private, non-profit agencies. These guarantors are reinsured by the United States Department of Education ("DOE"). The Authority is one such guarantor.

The Authority is the middleman of the GSLP, serving as the link between the lender and the DOE. It collects premiums from lenders (who pass on the premium cost to loan recipients) in exchange for its agreement to repay loans in default due to death, disability, bankruptcy or default of the borrower. When a default occurs the lender files a claim with the Authority and the Authority pays the claim. The Authority attempts to collect from the borrower the loan on which it has paid the default claim. The Authority also encourages program participation and verifies that lenders exercise due diligence. In addition to the premiums collected from lenders, the Authority is also funded by federal advances, federal administrative cost allowances and federal reinsurance payments; collections on defaulted loans; state appropriations; investments; and other sources.

The DOE administers the GSLP nationwide. It has numerous functions including the oversight of the operations of the lenders and guaranty agencies. The DOE makes subsidized interest and special allowance payments directly to the lenders and it reinsures the guarantees issued by the guaranty agencies. If a guaranty agency pays a lender's default claim, and both have exercised due diligence, the DOE makes a reinsurance

payment to the guaranty agency. The DOE also reimburses the guaranty agency for a portion of its administrative costs and provides advances to help it maintain adequate cash reserves for claims and other expenses. The relationship between the DOE and a guaranty agency is set forth in written agreements which are governed by certain federal statutes.

Under the Higher Education Act of 1965, 20 U.S.C. §§ 1071 *et seq.* ("the Act"), as amended in 1986, guaranty agencies are required to insure one hundred percent of the loan amounts for which they issue guarantees. 20 U.S.C. § 1078(b)(1)(G). The DOE, in turn, must reimburse one hundred percent of the amount expended by the agencies under its reinsurance obligations unless their claims rate exceeds a certain level. The 1986 amendments to the Act expressly grant "a contractual right" to guaranty agencies "as against the United States" to receive reinsurance payments and administrative cost allowances from the DOE. Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1268, 1376.

Congress became concerned about the federal costs associated with the program in 1986 and considered numerous amendments to reduce costs. Even as Congress worried about the federal costs, some state and private guarantors apparently were accumulating large surpluses in their reserve funds.[1] As a result of Congress's concern,

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[1] The term "reserves" is not defined in the Act or the DOE regulations. It refers to the reservoir of funds held by a guaranty agency for future contingencies, and it represents the cumulative amount of money available when the agency's total expenditures are subtracted from its total revenues.

the United States Comptroller General made numerous recommendations for reducing the federal costs attending the GSLP.

This action arises out of one of the Comptroller's recommendations accepted by Congress and included in the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 ("1987 amendments"), which was enacted on December 22, 1987, and will expire on September 30, 1989. The critical amendment establishes a cap on the amount of "excess reserves" that a guaranty agency may keep on hand and attempts to recoup all reserves beyond that cap. The 1987 amendments establish a formula, now codified at 20 U.S.C. § 1072(e)(1), for determining the maximum amount of funds a guaranty agency may accumulate in its reserve fund.

Under 20 U.S.C. § 1072(e)(2) the DOE Secretary must direct an agency whose cash reserves exceed the ceiling to "eliminate" the excess by (1) repaying advance payments that are not otherwise due; (2) withholding and cancelling reimbursement claims that are otherwise payable; (3) reducing the amount to be claimed for administrative costs; (4) paying an additional reinsurance fee; or (5) adopting any other acceptable method of reducing payments from or increasing payments to the federal government. The recovered amounts are deposited in the student loan insurance fund established by 20 U.S.C. § 1081(a) and are used exclusively for GSLP purposes.

The 1987 amendments authorize the Secretary to waive the requirements of 20 U.S.C. § 1072(e)(2) under an administrative appeals procedure. A waiver may be

granted if an agency would be compelled to violate contractual obligations existing on December 22, 1987, that require a specific level of cash reserves. A guaranty agency must apply for a waiver and the Secretary must respond in an expedited manner.

The 1987 amendments also modify the provisions granting the guaranty agency a "contract right" to reinsurance payments, administrative cost allowances and advances by making them subject to the cash reserve ceiling provisions. The amendments provide that a guaranty agency "shall, *subject to section 1072(e) of this title [the cash reserve ceiling provisions]*, be deemed to have a contractual right against the United States" to receive reimbursement for losses on insured loans. Similarly, the amendments provide that a guaranty agency "shall, *subject to section 1072(e) of this title*, be deemed to have a contractual right against the United States" to receive administrative cost allowances. Thus, although the Act had earlier expressly granted to the guaranty agency contractual rights to reinsurance reimbursements and administrative cost allowances, the 1987 amendments now make these rights contingent on the size of the agency's reserves.

On February 9, 1988, the Secretary notified the Authority that it had $2,739,528 in excess cash reserves and that it was required to eliminate the excess by one of the statutorily prescribed methods. Since that date the Authority has continued to submit requests for reinsurance and administrative cost reimbursements to the Secretary and the Secretary has refused to honor those requests. The reinsurance payments now being withheld relate to loans guaranteed by the Authority prior to

enactment of the 1987 amendments. The Authority applied for a waiver on the ground that it would be compelled to violate contractual obligations existing on December 22, 1987, if the 1987 amendments were applied to it but the Secretary denied the application. The Authority sued the DOE on October 17, 1988.[2] The parties have stipulated that the amount in controversy is $2,657.87 [sic] [$2,657,687].[3]

The Authority advances seven causes of action. In the first two causes of action it contends that the 1987 amendments constitute a "taking" without compensation of its property rights in its contracts with the defendants and in

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[2] At least three other district courts have issued rulings in virtually identical actions. In *Great Lakes Higher Education Corp. v. Cavazos,* No. 88-C-159-C (W.D. Wis. April 17, 1989), the District Court for the Western District of Wisconsin denied the plaintiff's motion for a preliminary injunction to enjoin the DOE from withholding reimbursement payments from the plaintiff because the plaintiff had an adequate remedy at law. The court in *Great Lakes* later granted summary judgment in favor of the DOE, discussed in greater detail, *infra*. The District Court for the Eastern District of Virginia likewise refused to grant the plaintiff temporary injunctive relief in *Virginia State Education Assistance Authority v. Cavazos,* No. 88-0874-R (E.D. Va. Jan. 10, 1989). In *Ohio Student Loan Comm'n v. Cavazos,* No. C-2-88-0314 (S.D. Ohio Dec. 19, 1988), the court held that the amendments are unconstitutional on several different grounds. On March 10, 1989, it issued an additional order rejecting new arguments of the plaintiff. The Sixth Circuit recently stayed the district court's order. *Ohio Student Loan Comm'n v. Cavazos,* No. 89-3168 and No. 89-3238 (6th Cir. filed May 23, 1989).

[3] Although the defendants have claimed $2,739,528 from the Authority, the Authority has agreed to pay $81,841 of this sum which, when deducted, leaves $2,657,687 as the amount in controversy.

its cash reserve fund in violation of the fifth amendment to the United States Constitution.[4] In the third cause of action, the Authority contends the 1987 amendments arbitrarily distinguish between guaranty agencies with excess cash reserves and those without cash reserves in violation of the equal protection clause of the fourteenth amendment to the United States Constitution. In the fourth cause of action, the Authority contends that the amendments breach its contracts with the defendants. In the fifth cause of action, the Authority contends the Secretary erroneously calculated the amount of its excess cash reserves in violation of the 1987 amendments. In the sixth cause of action, the Authority contends that elimination of its excess cash reserves would cause it to violate contractual obligations contrary to one of the provisions in the 1987 amendments. In the seventh cause of action, the Authority contends that the 1987 amendments call into question the validity of the public debt in violation of section four of the fourteenth amendment to the United States Constitution.[5]

The Authority seeks both declaratory and injunctive relief. It seeks a declaration that the 1987 amendments are unconstitutional, that the defendants miscalculated the amount of its excess cash reserves and that the defendants erroneously failed to grant it a waiver of the

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[4] U.S. Const. amend. V provides in part that "private property [shall not] be taken for public use, without just compensation."

[5] U.S. Const. amend. XIV, § 4 provides in part: "The validity of the public debt of the United States, authorized by law, . . . shall not be questioned."

requirements imposed by the 1987 amendments. The Authority also seeks to enjoin the defendants from offsetting amounts owed it by the federal government against its debt under the 1987 amendments.

The Authority originally moved for a preliminary injunction but that motion was withdrawn; both the Authority and the defendants have now moved for summary judgment on all issues.

II.

As noted earlier, Congress in 1986 expressly granted to the Authority a contractual right to receive the reinsurance reimbursement and the administrative cost allowances. Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1268, 1376. Congress then made the contractual rights subject to the 1987 amendments regarding limits on excess reserves. The Authority argues that Congress cannot relieve itself retroactively of its contractual obligations; on the other hand, the defendants argue that Congress is authorized to alter its obligations under this program.

The arguments on both sides revolve primarily around *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 106 S. Ct. 2390 (1986), and *The Sinking Fund Cases*, 99 U.S. (9 Otto) 700 (1879). In *The Sinking Fund Cases* Congress attempted to amend contracts the federal government had entered into with certain railroad companies. According to the contracts, Congress provided land to the railroads and entered into an agreement requiring the railroads to provide full payment for the land in thirty years. The railroads agreed to furnish the

government with transportation and telegraph transmissions on a preferential basis and to set aside toward payment of the principal and interest due on the subsidy bonds issued by Congress to finance railroad expansion fifty percent of the compensation due for these services plus five percent of annual net earnings. Apparently, the railroad companies accumulated more debt in extending the railroads than Congress had anticipated; despite this accumulation of debt, however, the railroads declared dividends rather than setting aside money for repayment of the subsidy bonds. Fearing that the railroads would not have enough to pay the substantial debt when it came due, Congress amended the legislation to require that the government apply one hundred percent of the compensation due the railroads to other sources (one-half to interest debt on the subsidy bonds and the other half invested in United States bonds in a sinking fund established in the United States Treasury). The railroads were also required to pay twenty-five percent of their earnings into the sinking fund. Proceeds of the sinking fund were to be used to pay all remaining interest and principal due on the subsidy bonds on the date of their maturity.

The United States Supreme Court held that the amendments did not deprive the railroads of due process.[6] The Court first noted that Congress, in the original

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[6] Before beginning its analysis, the Court noted that the United States is "prohibited from depriving persons or corporations of property without due process of law." 99 U.S. at 501. Whether *The Sinking Fund* cases are pure "due process" cases or whether the Court's analysis applies equally well to fifth amendment "taking without just compensation" and fourteenth amendment "questioning of the public debt" cases is

(Continued on following page)

legislation, had expressly reserved the right to amend the legislation. 99 U.S. at 719-20. The Court declared, "It is unnecessary to decide what power Congress would have had over the charter if the right of amendment had not been reserved; for as we think, that reservation has been made." *Id.* Next, the Court noted numerous factors underlying its decision: (1) the railroads had been paying money in dividends rather than preparing to pay a certain, and large, debt to the government; (2) the government was both a sovereign and a creditor and "[t]heir rights as sovereign are not crippled because they are creditors, and their privileges as creditors are not enlarged by the charter because of their sovereignty," *id.* at 724; and (3) "The original contracts of loan are not changed. They remain as they were before, and are only to be met at maturity. All that has been done is to make it the duty of the Company to lay by a portion of its current

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unclear. Mr. Chief Justice Waite described the issue as whether the amended statute "deprives the Company of its property without due process of law, *or in any other way improperly interferes with vested rights.*" *Id.* (emphasis added). Moreover, other decisions addressing similar facts have loosely referred to *The Sinking Fund Cases* both as taking cases, *see Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 48 (1986), and as questioning of the debt cases, *see Perry v. United States*, 294 U.S. 330, 354 (1934). Based on *Bowen* as well as on the breadth of *The Sinking Fund Cases* holding itself, this Court views *The Sinking Fund Cases* language establishing limits on legislation that alters the United States' contractual obligations as based not only on the due process clause of the fifth amendment but also on the taking clause of that amendment.

net income to meet its debts when they do fall due." *Id.* at 725.

The Court in *The Sinking Fund Cases*, however, used strong language in setting the outer limits of Congress's authority to alter its contractual obligations:

> [Congress] cannot legislate back to [itself], without making compensation, the lands they have given this Corporation to aid in the construction of its railroad. Neither can they by legislation compel the Corporation to discharge its obligations in respect to the subsidy bonds otherwise than according to the terms of the contract already made in that connection. The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen. No change can be made in the title created by the grant of the lands, or in the contract for the subsidy bonds, without the consent of the corporation. All this is indisputable.

99 U.S. at 719.

In addition, the Court decided that, even if Congress expressly retains authority to amend its contracts in the legislation authorizing the contracts, it cannot take away benefits already conferred under the contracts:

> That this power [to alter obligations under a contract by amending authorizing legislation] has a limit, no one can doubt. All agree that it cannot be used to take away property already acquired under the operation of the charter, or to deprive the Corporation of the fruits actually reduced to possession of contracts lawfully made.

. . .

. . . .

> . . . [W]hatever rules Congress might have prescribed in the original charter for the government of the Corporation in the administration of its affairs, it retained the power to establish by amendment. In so doing it cannot undo what has already been done, and it cannot unmake contracts that have already been made, but it may provide for what shall be done in the future, and may direct what preparation shall be made for the due performance of contracts already entered into.

Id. at 720-21.

The United States Supreme Court addressed a similar issue in *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986). The issue there was whether, by amending the social security legislation, Congress could deprive a state of the prerogative originally granted in that statute and in an agreement tracking the statutory language to withdraw from the social security program. The Court held that Congress had in the original act reserved the power to amend it and could so amend it because the act itself created no property right under the fifth amendment. The Court observed that "[t]he State accepted the Agreement under an Act that contained the language of reservation. That language expressly notified the State that Congress retained the power to amend the law under which the Agreement was executed and by amending that law to alter the Agreement itself." *Id.* It continued, "Congress does not have the power to repudiate its own debts, which constitute 'property' to the lender, simply in order to save money," but the section of the social security act at issue was neither a

debt of the United States nor an obligation of the United States to provide benefits under a contract for which the obligee paid a monetary premium, and hence did not rise to the level of a protected property right. *Id.* at 55.

Thus, under *The Sinking Fund Cases* and *Bowen*, Congress can alter its agreements if it expressly retains that right in the legislation under which agreements are entered into. As a limit on that rule, however, the United States Supreme Court has made clear that Congress cannot "unmake" contracts in which the other party has acquired a property right, even if it has retained the authority to amend the legislation and thereby the contracts. The first question here, then, is whether the Authority has acquired a property right in the contracts it entered into with the Secretary pursuant to the Higher Education Act before the 1987 amendments. If the Authority has a property right under the contracts to receive reimbursement for guaranty payments and administrative cost allowances, Congress cannot empower the defendants to take away that property right without either the Authority's consent or just compensation.

In *White v. United States*, 270 U.S. 175 (1926), and *Lynch v. United States*, 292 U.S. 571 (1934), the United States Supreme Court established guidelines for determining when a party to a contract with the federal government has an enforceable property right in the contract. In *White* a soldier purchased a life insurance policy from the government and named his mother and his aunt as beneficiaries of one-half of the proceeds each. When he entered into the contract, the statute providing the insurance did not list "aunts" as allowed beneficiaries. Before

he died the statute was amended to include aunts as beneficiaries. Later, after the insured died, his mother contended that she was entitled to the full proceeds because the amendment could not constitutionally alter the terms of the statute in effect when her son purchased the insurance. The certificate of insurance provided that it was " 'subject in all respects to the provisions of such Act, of any amendments thereto, and of all regulations thereunder, now in force or hereafter adopted, all of which, together with the application for this insurance, and the terms and conditions published under authority of the Act, shall constitute the contract.' " *White*, 270 U.S. at 180. The Court ruled against the mother, basing its decision on the facts that the policy was a contract between the deceased and the government, it was expressly subject to changes in the governing statute and the insured's mother could have acquired no rights under the contract until the son died, which occurred after the amendment to the statute. Because the plaintiff (the mother) was not a party to the contract and her interest could not have vested until after the amendment was enacted, the issue presented and decided was a standing issue, that is, "one whose vested rights were not thereby disturbed could not complain of subsequent legislation affecting the terms of the policy." *Lynch*, 292 U.S. at 577. The questions left unanswered by *White* include when a party's rights are considered vested and, if vested, when they can be divested by subsequent legislation.

Lynch assists in answering these questions. There, beneficiaries under government-issued life insurance policies claimed that Congress unconstitutionally repealed the act providing for the policies after having issued and

accepted premiums for the policies. The Court declared, apparently on both due process and taking without compensation grounds, that the amendment disavowing the insurance policies was unconstitutional:

> The repeal, if valid, abrogated outstanding contracts; and relieved the United States from all liability on the contracts without making compensation to the beneficiaries. . . . The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a principality, a State or the United States. Rights against the United States arising out of a contract with it are protected by the Fifth Amendment.
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> . . . .
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> In the administration of all government business economy had become urgent because of lessened revenues and the heavy obligations to be issued in the hope of relieving widespread distress. Congress was free to reduce gratuities deemed excessive. But Congress was without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an act of repudiation.

Id. at 579-80.[7]

Significantly, the original act in *Lynch* did not include language reserving to the government the right to alter the contracts entered into under the statute by amendment, unlike the legislation in *The Sinking Fund Cases* and

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[7] *See id.* at 579 (for due process discussion); *see infra* n. 9.

in *Bowen*. The contracts of insurance themselves, however, stated that the policy "should be subject to all amendments to the original Act, to all regulations then in force or thereafter adopted." *Id.* The policy form in which this language appeared was prepared by the Veterans Administration. The Court nevertheless concluded that "no power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator." *Id.* at 578. In this Court's view, *Lynch* manifests that language reserving to Congress the power to amend legislation and contracts entered under it must be in the legislation itself to be effective.

The defendants argue, however, that no property right vested in the Authority because the Secretary included, in the regulations issued pursuant to the Higher Education Act and in the contracts between the Authority and the DOE, language reserving to Congress the right to amend the contracts. The defendants rely on the Supreme Court's language in *Bowen* that the provision of the legislation at issue there "simply cannot be viewed as conferring any sort of 'vested right' in the face of precedent concerning the effect of Congress' reserved power on agreements entered into under a statute containing the language of reservation." *Bowen*, 477 U.S. at 55. The Court concluded, therefore, that "[s]ince appellees had no property right in the termination clause, [the statute] did not effect a taking within the meaning of the Fifth Amendment." *Id.* at 55-56.

On the basis of this language the defendants argue that the Authority could not possess a property right in its contracts with the federal government because of the

notice of Congress's ability to amend the Higher Education Act contained in the Secretary's regulations and in the contracts. Indeed, a recent opinion supports the defendants' reading of *Bowen*. In *Great Lakes Higher Education Corp. v. Cavazos*, No. 88-C-159-C (W.D. Wis. April 17, 1989), the court interpreted *Bowen* to mean that "a contractual right arising out of a contract governed by an act subject to the express reservation of Congress's power to amend is not a right that constitutes property protected by the Fifth Amendment." *Id.* at 21.

This Court does not agree with the defendants' argument or with the ruling in *Great Lakes*. First, such a reading of *Bowen* disregards the development of the law in this area beginning with *The Sinking Fund Cases*. In *The Sinking Fund Cases* the Supreme Court expressly declared that, regardless of whether Congress reserves the power to amend an agreement made pursuant to a statute by amending the statute, Congress's power to amend an agreement has limits, as this Court earlier discussed, *supra*. If, as the defendants contend, a party to a contract with the federal government under these circumstances does not possess a property right in its contract with the government, then, contrary to *The Sinking Fund Cases*, the power of Congress to alter its obligations under a contract containing a reservation of power to amend would be effectively unlimited because no party to that contract could ever acquire a property right to the benefits due under the contract. Faith in contracts with the government would be seriously shaken by such a ruling.

The defendants' and *Great Lakes's* reliance on *Bowen*, however, is misplaced. First, unlike the reservation of Congress's power in the *Bowen* legislation, the reservation

of power to amend the contracts made under the Higher Education Act is contained not in the Act, but instead only in the regulations issued by the Secretary and in the contracts themselves.[8] *Lynch* makes clear the significance of this distinction in holding that a reservation of power to amend the act in question contained only in the regulations promulgated under the act and in the insurance contract authorized by the act but not in the act did not reserve to Congress amendatory power. As noted earlier, the Supreme court held that "no power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator." *Lynch*, 292 U.S. at 578. Applying this language here, this Court concludes that the Secretary cannot in his regulations reserve to Congress the power to amend its contracts with the Authority by amending the statute under which the contracts were entered into; only Congress can do that. Nor can such power be created by a term in the contract between the Secretary and the Authority. Nonetheless the defendants argue that, because notice of reservation is included in the contract and because the Authority is more likely to read the contract than the statute, the notice here is sufficient. The issue. however, is not notice; the issue is whether Congress reserved the

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[8] The agreements expressly provide that the Authority "shall be bound by all changes in the Act or Regulations in accordance with their effective dates." Complaint, Exhibit B, ¶ 1. The Secretary's regulations similarly provide that all agreements are "subject to subsequent changes in the Act or the regulations that apply to the [GSL] Program." 34 C.F.R. 682.400(d).

power to amend the contract. Here, it did not, and the notice provisions in the contract and in the regulations cannot grant such power.

Accordingly, the Court concludes that here, as in *Lynch*, the Authority has vested property rights in its contracts with the United States to receive reimbursement for payments made to guarantee defaulted loans and to receive advances and administrative cost allowances. As in *Lynch*, the Authority is a party to the contract and has paid valuable consideration for its right to receive reinsurance payments, administrative cost reimbursements and advances – it has agreed to guarantee the loans and it has administered the GSLP on the state level, acting as the middleman between the federal government and the lending institutions. Furthermore, Congress expressly provided in the 1986 amendments that the Authority has a "contractual right" to receive reinsurance payments and administrative cost allowances. This Court rejects the reasoning in *Great Lakes* that these rights could not vest, and instead finds that the Authority's rights constitute property. Because they do constitute property, then, even if a reservation of power to amend the contracts were contained in the legislation authorizing them, Congress could not by amending the legislation take away that property. *The Sinking Fund Cases*, 99 U.S. at 720.

This Court further rejects the defendants' argument that they may withhold these payments as a means of enforcing the requirement in the 1987 amendments that the Authority reduce its excess cash reserves. The defendants contend that the federal government regularly withholds funding for certain programs in order to assure compliance with certain policies and that the withholding

of reinsurance payments here is no different. Here, however, the requirement that the Secretary is attempting to enforce is itself not binding on the Authority. "The United States are as much bound by their contracts as are individuals." *Id.* at 719. Thus, just as the Authority could not unilaterally require the Secretary to pay it additional consideration to continue its role in the GSLP, the Secretary cannot unilaterally require the Authority to pay a ransom in order to continue receiving both reimbursments for monies already paid out and administrative cost allowances and advances in accordance with the contract.

Finally, there is no difference of legal significance among the prescribed methods the defendants are authorized to use to enforce the 1987 amendments. Regardless of the means chosen to attempt to force the Authority to comply with the requirements of the 1987 amendments, any attempt to coerce its compliance without just compensation constitutes an unconstitutional taking of the Authority's property rights in its contracts with the federal government under the fifth amendment to the United States Constitution and is therefore unconstitutional.

III.

Accordingly, the Court declares that the 1987 amendments authorize the taking of the Authority's property without just compensation in violation of the fifth amendment to the United States Constitution and are unconstitutional.[9] The Secretary is enjoined from

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[9] Because the Court finds the 1987 amendments violate the fifth amendment proscription against taking property without

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offsetting the Authority's excess cash reserves against future reinsurance payments or other federal payments to which the Authority would otherwise be entitled pursuant to its contracts with the United States. The defendants are ordered to release to the Authority the funds which they have wrongfully withheld within thirty days of the date this order is filed.

IT IS SO ORDERED.

/s/ Karen LeCraft Henderson
KAREN LeCRAFT HENDERSON
UNITED STATES DISTRICT
JUDGE

Columbia, South Carolina
May 31, 1989

Jane Adams
Deputy Clerk

(Continued from previous page)

just compensation, it does not reach the Authority's claims that the amendments violate the due process clause of the fifth amendment, the equal protection clause of the fourteenth amendment and the questioning of the public debt clause of the fourteenth amendment. The Court also does not reach the Authority's allegations that the Secretary miscalculated its excess reserves and that he erroneously failed to grant a waiver to the Authority.

EXHIBIT E

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA
COLUMBIA DIVISION

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY, Plaintiff,	)	
v.	)	No. 3:88-2710-16
LAURO F. CAVAZOS, Secretary of Education, and UNITED STATES DEPARTMENT OF EDUCATION, Defendants.	)	

ORDER

(Filed Jul 6, 1989)

Defendants' motions to alter judgment and for stay pending disposition of motion to alter judgment are DENIED.

/s/ Karen LeCraft Henderson
JUDGE KAREN LeCRAFT HENDERSON

Dated: July 5, 1989

EXHIBIT F

20 U.S.C. § 1078(c)(1)(A) (1986 Supp.)

(c) Guaranty agreements for reimbursing losses

(1) Authority to enter into agreements

(A) The Secretary may enter into a guaranty agreement with any guaranty agency, whereby the Secretary shall undertake to reimburse it, under such terms and conditions as the Secretary may establish, with respect to losses (resulting from the default of the student borrower) on the unpaid balance of the principal and accrued interest of any insured loan, including the administrative costs of supplemental preclaim assistance for default prevention as defined in paragraph (6)(C). The guaranty agency shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement according to the provisions of this subsection. Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in paragraph (7), the amount to be paid a guaranty agency as reimbursement under this subsection shall be equal to 100 percent of the amount expended by it in discharge of its insurance obligation incurred under its loan insurance program. In no case shall a guaranty agency file a claim under this subsection for reimbursement with respect to losses prior to 270 days after the loan becomes delinquent with respect to any installment thereon.

Exhibit G

PUB. L. NO. 100-203, 101 STAT. 1330-36

SEC. 3001. RECOVERY OF EXCESS CASH RESERVES ACCUMULATED UNDER THE GUARANTEED STUDENT LOAN PROGRAM

(a) IN GENERAL – Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is amended by adding at the end thereof the following new subsection:

"(e) REDUCTION OF EXCESS CASH RESERVES. –

"(1) LIMITATION ON MAXIMUM CASH RESERVES – A guaranty agency shall not accumulate case reserves in excess of the greater of –

"(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;

"(B) 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;

"(C) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount;

"(D) $500,000; or

"(E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

"(2) RECOVERY OF EXCESS CASH RESERVES. – The Secretary shall, not later than March 31, 1988, determine for each guaranty agency the maximum cash reserve permitted under paragraph (1) for fiscal year 1986. Subject

to paragraphs (3) and (4), if the Secretary determines that any guaranty agency had, at the end of fiscal year 1986, a cash reserve that exceeded such maximum, the Secretary shall direct the agency to eliminate such excess by any one or more of the following methods, as selected by the guaranty agency:

"(A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d);

"(B) by withholding and canceling claims for reimbursement otherwise payable under section 428(c)(1);

"(C) by reducing the amount of payment for which application will be made by such agency under section 428(f); or

"(D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees in addition to the fees required by section 428(c)(9), as proposed by the agency and agreed to by the Secretary.

"(3) APPEALS BASED ON SPECIAL CIRCUMSTANCES. – (A) If the Secretary determines, on the basis of an application from a guaranty agency, that –

"(i) the agency's financial position has deteriorated significantly since the end of the preceding fiscal year;

"(ii) significant changes in the economic circumstances (such as a change in agency current cash reserves) or the load insurance program render the limitations of paragraph (1) inadequate for the continued functioning of the agency; or

"(iii) in recovering funds as required by this subsection, a guaranty agency would be compelled to violate contractual obligations existing on the date of enactment of this subsection that require a specified level of reserve funds to be maintained by such agency;

the Secretary may waive, in whole or in part, the imposition of the remedies required by paragraph (2) for such agency.

"(B) The Secretary shall respond to request for waivers from guaranty agencies in an expedited manner and, except for unusual circumstances or with the consent of the guaranty agency, shall resolve such request within 6 weeks of submission.

"(4) RECOVERY LIMITS. – The Secretary shall not require a total reduction of cash reserves for all guaranty agencies in excess of $250,000,000 during fiscal year 1988. If the total of cash reserves of all guaranty agencies exceeds the maximum amounts permitted under paragraph (1) by more than $250,000,000, the Secretary shall ratably reduce the amounts that guaranty agencies are directed to eliminate under paragraph (2), so that the total excess cash reserves to be eliminated equals $250,000,000.

"(5) DEFINITIONS. – As used in this subsection –

"(A) the 'cash reserves' for any guaranty agency for any fiscal year are equal to the agency's cumulative cash receipts less the agency's cumulative cash disbursements at the end of such fiscal year;

"(B) the 'total reserves' for any guaranty agency for any fiscal year are equal to

the agency's cash reserves plus the agency's cumulative accounts receivable less the agency's accounts payable, as of the end of such fiscal year;

"(C) the term 'cumulative cash receipts' includes such receipts as insurance premiums, Federal reinsurance payments, and collections on defaulted loans;

"(D) the term 'cumulative cash disbursements' includes such disbursements as payments for default claims, repayment of Federal advances, transfers to other State activities, and payment of collection costs and other operating costs;

"(E) the term 'accounts receivable' includes Federal reinsurance payments and administrative cost allowances owed but not yet paid to the guaranty agency, as of the end of a fiscal year; and

"(F) the term 'accounts payable' includes collections and reinsurance fees due (but not paid) to the Department of Education, as of the end of a fiscal year.".

(b) CONFORMING AMENDMENTS. –

(1) The second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

(2) Section 428(c)(9)(A) of such Act is amended by striking out "an amount equal to" and inserting "an amount, subject to section 422(e), equal to".

(3) The second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall be deemed"

and inserting "shall, subject to section 422(e), be deemed".

EXHIBIT H

§ 59-115-50. Powers of Authority.

The Authority shall be empowered as follows:

(a) To make student loans under such terms and conditions as the Authority shall from time to time prescribe;

(b) To insure student loans under such terms and conditions as the Authority shall from time to time prescribe;

(c) To guarantee student loans under such terms and conditions as the Authority shall from time to time prescribe;

(d) To acquire contingent interest in student loans from banks or other lending institutions (up to one hundred percent of the face amount thereof) under such terms and conditions as the Authority shall from time to time prescribe;

(e) To develop and administer all programs and to perform all functions necessary or convenient to promote and facilitate the making, guaranteeing and insuring of student loans and to provide such other student loan assistance and services as the authority shall deem necessary or desirable and to enable it to qualify for loans, grants, insurance and other benefits and assistance under any program of the United States now or hereafter authorized fostering student loans;

(f) To appoint one or more banking institutions as its fiscal agent to perform such functions with respect to student loans and its revenue bonds as the Authority shall from time to time prescribe; and

(g) To approve as eligible, institutions otherwise qualified as such.

(h) To sell or otherwise hypothecate student loans or other securities held by the authority in any fund created hereby.

EXHIBIT I

§ 59-115-60. State Education Assistance Authority Loan Fund.

There shall be established and maintained by the authority a fund which shall be designated the "State Education Assistance Authority Loan Fund". There shall be deposited to the credit of the loan fund the proceeds, exclusive of accrued interest, derived from the sale of the revenue bonds of the authority and any other moneys made available to the authority for making student loans.

There also may be deposited in the loan fund the "spread" or difference between the average rate of interest paid by the authority on its revenue bonds and the interest received by the authority on student loans as well as any state appropriated funds or other funds made available for administration of the loan program authorized herein.

Moneys in the loan fund shall be used only for the following purposes:

(a) To make direct loans to students.

(b) To make loans to any not-for-profit corporate entity approved by the authority for the purpose of enabling the entity to make student loans on terms and under conditions approved by the authority.

(c) To defray the expenses of operation and administration of the authority and its programs for which other funds are not available to the authority.

(d) To remedy any deficiency in the loan guarantee reserve fund.

(e) To remedy any deficiency in the sinking fund.

Pending the use of moneys in the loan fund for any of its authorized purposes the moneys shall be invested and reinvested by the State Treasurer. All earnings from the investments shall be added to and become a part of the loan fund.

EXHIBIT J

§ 59-115-70. Sinking fund; State Education Assistance Authority Loan Guarantee Reserve Fund.

Prior to the issuance of any revenue bonds a sinking fund shall be established, the custodian of which shall be the State Treasurer. There shall be deposited in the sinking fund the revenues from all of the sources pledged for the payment of the revenue bonds including all moneys received directly or indirectly by way of principal and interest, exclusive of the "spread" referred to in § 59-115-60, from the repayment of student loans. Except to the extent of any surplus therein, moneys in the sinking fund shall be used for the sole purpose of paying the principal of and interest on revenue bonds of the authority from time to time outstanding.

In the event that the authority shall undertake to guarantee student loans, there shall be established and maintained by the authority a trust fund which shall be designed the "State Education Assistance Authority Loan Guarantee Reserve Fund". The fund shall be used by the authority to remedy defaults on student loans to the extent such defaulted loans are not covered by any existing or future program of federal insurance or reinsurance. There shall be deposited to the credit of the loan guarantee reserve fund all premiums received by the authority for guaranteeing student loans and all moneys made available to the authority for the guaranteeing of student loans including federal funds made available for such purpose. Moneys in the fund shall not be pledged to the repayment of the authority's revenue bonds, but if all liability of the authority to remedy defaults on student loans have been extinguished such moneys remaining in

the loan guarantee reserve fund shall be deposited in the sinking fund. The liability of the State upon its obligation to guarantee student loans shall not constitute a pledge of the faith and credit of the State but shall be payable solely from moneys in the loan guarantee reserve fund.

EXHIBIT K

§ 59-115-100. Fees, charges, interest and premiums; contracts with United States and others; pledge of money in sinking fund.

The authority is authorized to fix and collect fees, charges, interest and premiums for making, insuring or guaranteeing student loans, purchasing, endorsing or guaranteeing obligations and any other services performed under this chapter. The authority is further authorized to contract with the United States of America or any agency or officer thereof and with any person, partnership association, banking institution or other corporation respecting the carrying out of the authority's functions under this chapter. . . . [sinking fund pledge omitted]

EXHIBIT L

§ 59-115-110. All money received deemed trust funds; investment thereof.

Notwithstanding any other provisions of law to the contrary, all money received pursuant to the authority of the chapter, whether as proceeds from the sale of bonds, sale of property or insurance, or as payments of student loans, whether principal, interest or penalties, if any, thereon, or as insurance premiums, or from the purchase or sale of obligations, or as any other receipts or revenues derived hereunder, shall be deemed as trust funds to be held and applied solely as provided in this chapter. The resolution authorizing the bonds or any issues may provide that any of such money may be temporarily invested in securities authorized by §§ 6-5-10 to 6-5-40, pending the disbursement thereof and shall provide that any officer with whom, or any bank or trust company with which, such money shall be deposited shall act as trustee of such money and shall hold and apply the money for the purpose hereof, subject to such regulations as this chapter and such resolution may provide.